

# The coalition risks following the wrong path on childcare reform

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## EXCERPTS:

As part of next week's Budget, the Chancellor is expected to announce reforms to the funding of childcare. While action on childcare is welcome, it is likely the changes will see a greater proportion of childcare funding flowing via parents to purchase childcare, rather than invested in services free at the point of use. The experience of other countries with a similar market-led system is that rather than leading to cheaper care, pumping more money into the market via parents leads to greater cost inflation, with little change in affordability. If the government really wants to go big on childcare, it should invest more money in services, rather than benefits.

What is going to be announced? Since the 're-launch' of the coalition in January, there have been numerous hints in the media. Despite widely-reported disagreement between the coalition partners, it appears the government has settled on offering greater funding to better-off parents via some kind of tax relief, combined with additional money tied to Universal Credit for poorer families. Beyond the previously-announced extension of the free Early Years Entitlement to the 40 per cent of poorest two-year olds, there is little sign that the coalition is looking to expand the free offer, preferring instead to give money to parents.

While it is good that the government is looking at greater childcare funding, we have to ask whether this is the best use of extremely scarce resources. The coalition hopes that putting more money in the hands of parents will lead to greater purchasing power in the market for childcare, with increased competition and innovation among providers acting to keep prices low and stable. But will this actually be the case?

In order to answer that question, we should look to the country that has been most committed to this style of funding. Australia enacted wide-reaching reforms to childcare over the last two decades, combining a mixture of de-regulation and increases in childcare benefits, whilst at the same time effectively shutting off direct funding to childcare providers.

What happened to prices? The Australian Bureau of Statistics collects robust inflation data on the cost of childcare. Looking at how prices evolved before and after the reforms provides a stark picture of the dangers attached to the changes being considered here in the UK.

In the ten years before the 1997 reforms, the price of childcare rose on average by 5.2 per cent a year, around a fifth higher than the general rate of inflation. But in the decade after 1997 relative cost inflation rocketed, with childcare prices rising by 7.2 per cent annually, more than two and a half times wider inflation. In 2008, rather than reverse course, the Australian government doubled down on their inflationary approach, increasing the value of the tax rebate offered to families. If anything it appears this worsened childcare costs - In the year to March 2012 prices rose by almost 10 per cent.

What is it about childcare that leads to this outcome? Why doesn't parental purchasing power manage to keep costs low? Simply put, the market for childcare does not function like most competitive markets. It is inherently localised, risky for those looking to set up a business and vulnerable to severe cost pressures from staff outlays and rent inflation. Like many other public goods, it is better to let the state pool these risks and offer long-term and sustainable funding to keep costs low, rather than leave it to the market.

Will this experience be repeated here in the UK? All the signs are that the UK, which already has internationally high childcare prices, is set for further inflationary pressure. The sector in general is unprofitable, with a quarter of childminders operating at a loss last year, meaning prices may need to rise just to keep many businesses afloat. And surveys of the UK market suggest that the qualifications profile of staff in the sector has risen in recent years, but with little change in real wages. Having a higher-skilled workforce in the sector is welcome, but is likely to exert cost pressures in the near-term. All this will be compounded by the changes that will be made next week.

Throwing more money into a system that is struggling to stay afloat, as the coalition is planning to do, may look good on paper, but without controls on prices there is a real risk that the instant benefit families feel after next weeks changes will soon be eroded by price rises. Providers will see their existing set of users have a greater ability to pay, and, because of the difficulty of turning a profit in the sector, will understandably look to raise prices. Far from being a gold rush for the sector, these changes are more likely to re-enforce the status quo. At a time when there is little money around, this risks being a highly wasteful use of public resources.

What the childcare sector and parents really needs is higher and more sustainable funding for providers, with a greater number of hours offered free or at low cost to parents. It would be wrong to claim this comes cheap. Indeed, countries that have followed such a route, like Denmark and Sweden, tend to spend a larger proportion of GDP on childcare and early years provision. But by controlling the cost to parents directly, and offering a longer-term and more predictable source of funding to providers, there are real efficiency gains to be made

under such a system.

All three main political parties realise the importance of childcare, and accept there is a role for the public sector in making it affordable. This is welcome. But how we go about funding childcare, either via parents or through providers and price controls, needs to be rigorously debated. We currently have a mixed system in the UK, with some free places through the Early Years Entitlement and some subsidies via the benefits system. It appears the coalition favours the latter. It is important that we realise the dangers of such an approach, and look towards a much more sustainable future for UK childcare.

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